

<b>TRANSMITTAL SLIP</b>		DATE <i>28 Feb 85</i>
TO: <i>OSWR/P6/PS</i>		
ROOM NO. <i>5F46</i>	BUILDING <i>Hq</i>	
REMARKS:		
<p>FROM: <i>OSWR/TTAG</i> Rm. 6C43, X4423</p>		
ROOM NO.	BUILDING	EXTENSION

FORM NO. 241  
1 FEB 55

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WHICH MAY BE USED.

(47)

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Central Intelligence Agency



Washington, D.C. 20505

22 FEB 1985

MEMORANDUM FOR: Deputy Assistant Secretary for  
International Trade Controls  
Bureau of Economic and Business Affairs  
Department of State

THROUGH : Robert Strand  
Acting Director, INR/PMA

SUBJECT : Requested Technology Transfer Study on  
Malaysia [redacted]

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Attached is a copy of the study you requested from  
the Technology Transfer Assessment Center on  
Malaysia. We hope that it will be helpful to Deputy  
Assistant Secretary Tahtinen [redacted]

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[redacted] If we can be of  
additional assistance, please do not hesitate to let us  
know.

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[redacted]  
Director  
Scientific and Weapons Research

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Attachment  
As stated

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Central Intelligence Agency



Washington, D.C. 20505

## DIRECTORATE OF INTELLIGENCE

14 February 1985

THE POTENTIAL FOR TECHNOLOGY TRANSFER LOSSES  
FROM AND THROUGH MALAYSIA [REDACTED]

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Summary

Since the early 1970s, the Malaysian Government has introduced a number of economic incentives which have been largely responsible for the development of the electronics industry in the country. Despite a less attractive investment climate in recent years, many firms are expanding and diversifying their operations. Malaysia is a non-aligned state whose policy of equidistance is moderated by its push for industrial modernization and its suspicion of both the Soviet Union and China. In the second half of 1984, however, Malaysia moved to expand trade relations with both Communist countries. Malaysia does control sixty types of export goods, but none of these are high technology items. Indigenous Malaysian industry in the near to mid-term will probably not be a target of aquisition efforts. Therefore, we believe the primary control problem would be the potential for transshipment diversion. [REDACTED]

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This memorandum was requested by Deputy Assistant Secretary Tahtinen. It was prepared by [REDACTED] Technology Transfer Assessment Center, Office of Scientific and Weapons Research. Comments and inquiries are welcome and may be addressed to the Chief, Technology Transfer Assessment Center, OSWR [REDACTED]

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## CONCLUSIONS

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Recently, concerns have been expressed [redacted]  
[redacted] that Malaysia constitutes a potential high risk for  
diversion [redacted]

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[redacted] given Malaysia's increasing role in world trade and its  
commitment to high technology industries, the potential for diversions of  
Western-controlled equipment exists. However, this potential is minimal  
when compared to current diversion activities in countries [redacted]  
[redacted]

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We do not believe that Malaysian industry currently provides any  
significant targets for technology acquisition efforts. It is unlikely  
that Malaysia will develop indigenous technology equal even to that of the  
Warsaw Pact countries, much less to that of the industrial West in the  
short to mid- term. Therefore, we believe the primary control problem  
would be the potential for diversions of products and equipment from the  
industrialized West through Malaysia. [redacted]

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[redacted] we do not  
believe that Malaysia will become a significant transshipment point for  
diversions. [redacted]

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Despite this conclusion, we should add that this estimation could  
change if Mahathir's goal of turning Malaysia into the "fifth tiger" of the  
Far East--alongside Hong Kong, Taiwan, South Korea, and Singapore--is  
realized. In this case, the indigenous microelectronics industry could  
become a target of acquisition efforts. This would be especially true for  
diversions to the PRC, since the Chinese are geographically better situated  
to exploit technology transfer through Malaysia and are interested in  
acquiring technology which falls short of state-of-the-art. [redacted]

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## GENERAL BACKGROUND

Since the early 1970s, the Malaysian Government has instituted a number  
of measures designed to provide a favorable climate for foreign investment.  
These include tax incentive policies--such as "tax-free holidays" of up to  
ten years for so-called "pioneer industries"--and the establishment of  
customs free areas known as Free Trade Zones (FTZs). In addition, the  
Government recently relaxed its foreign investment regulations; 100 percent  
foreign ownership is allowed for more industries. [redacted]

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[REDACTED]

In part because of the recession in the early 1980s, the Malaysian Government is sensitive to the problems resulting from dependence on exports of primary commodities such as rubber and tin to generate GNP growth and hard currency earnings. As a result, it has begun a concerted effort to diversify its economy by emphasizing high technology and up-scale resource-based industries and by urging foreign investors to expand operations. The Malaysian Government is pushing development of an indigenous electronics industry in addition to urging foreign investors to diversify their operations. According to an Embassy report, Prime Minister Mahathir Mohammed plans to create a Malaysian Institute of Microelectronic Systems (MIMOS). Based in Kuala Lumpur, MIMOS is to become a research and development center for an indigenous Malaysian electronics industry. A Centre for Computer Training in Malaysia was established in 1982. [REDACTED]

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As yet, however, the Malaysian electronics industry is driven primarily by foreign investment and is only just beginning to advance beyond the assembly stage. It is too soon to project the level of success of these initiatives; a great deal will depend on whether Malaysia can make it worthwhile for foreign investors--not only to remain in Malaysia, but also to expand their operations in accordance with Mahathir's ambitions. According to an Embassy report, American businessmen have complained that the GOM expects them to take the lead in developing the Malaysian electronics industry. [REDACTED]

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#### MICROELECTRONICS INDUSTRY

The economic incentives described above have been largely responsible for the development of the electronics industry in Malaysia; there are now more than 100 electronics companies located in the FTZs. There are limitations to the growth of the electronics industry, however: in FTZs such as Penang, companies are beginning to experience labor shortages. Foreign investors are concerned over the recent drive towards unionization at a time when automation and rising local wages are prompting US and Japanese companies to consider relocation. The ten-year tax free holidays are expiring for many pioneer companies. [REDACTED]

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The majority of large multinationals, however, apparently believe these problems can be controlled. Many firms are expanding their operations.

[REDACTED]

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Although some locally-owned businesses are active, subsidiaries of multinational firms dominate the electronics sector in Malaysia. Their main activity is microelectronics assembly, but a growing number of foreign

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[redacted]

and local firms are moving into production of telecommunications and computer-related equipment, as well as support industries. Microelectronics operations in Malaysia have become more sophisticated over the past few years, moving gradually from strictly assembly work to assembly, testing, and packaging. According to an Embassy report, more than 30 firms have established facilities for the assembly and testing of discrete devices, microprocessors, memory circuits, LEDs and LCDs and photovoltaic cells. Two firms are involved in wafer production. [redacted]

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The subsidiaries of several multinational telecommunications firms--Northern Telecom, NEC, and Plessey--produce modems, crossbar exchanges, multiplexers, and private automatic branch exchanges (PABX's). Mobile VHF communication equipment is also manufactured locally. Telecommunications-related production will probably expand in the wake of last year's decision to privatize certain segments of the industry. [redacted]

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Only oil outranks electronic components and equipment as Malaysia's leading earner of foreign exchange. Malaysia is now a major exporter of assembled semiconductor devices to the U.S. Foreign exchange earnings for electronic components in 1983 exceeded \$2 billion, with microelectronics exports alone totalling \$1.7 billion. [redacted]

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#### EXPORT CONTROLS

Historically, the purpose of Malaysian export controls has been to protect domestic industries through export quotas or to reflect Government foreign policy, as in the case of current embargos of all trade with South Africa and Israel. The Ministry of Trade and Industry has primary authority over exports and is responsible for issuing export licenses. Other ministries or government offices, however, can perform a control function depending on the item to be exported. [redacted]

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[redacted] the Director of Customs has wide authority to prevent the export of controlled items. [redacted]

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Authority for Malaysian export controls stems from the 1967 Customs Act. Either a specific or general export license--depending on the product or commodity--is issued to an individual or firm exporting goods specified under this act. The import and export guide notes that items not mentioned may be imported or exported without recourse to a license. There are sixty types of goods which require an export license; high technology items and other goods which would be CoCom-controlled are not among them. The Malaysian authorities do not provide any formal kind of import certificates or delivery verification certificates. Malaysian Customs apparently has no computer capability to track items in transit. [redacted]

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[REDACTED]

Firms located in the FTZs are prohibited from importing their products directly into Malaysia. FTZs fall under local jurisdiction, although Malaysian Customs maintains officers at entry/exit points. There are no intra-government agreements covering the movement of items in-transit across more than one customs zone. For items in-bond and in-transit, customs can inspect documents, conduct spot checks, seize goods, and prosecute export control violators, if goods leave the customs territory or if documents are falsified. [REDACTED]

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#### RELATIONSHIP WITH COMMUNIST COUNTRIES

The Malaysian Government characterizes itself as a non-aligned, Muslim state. Malaysia is also one of six member nations of the Association of Southeast Asian Nations (ASEAN). These two factors heavily influence Malaysia's foreign policy. As a member of ASEAN, Malaysia supports that organization's adherence to the concept of a Zone of Peace and Freedom and Neutrality, although the implementation of this ideal is hindered by Vietnam's continued presence in Cambodia. As a non-aligned nation, Malaysia professes to pursue a policy of equidistance between the superpowers. This stance is moderated, however, by the Government's determination to become the "fifth tiger" of the Far East, alongside Hong Kong, Taiwan, South Korea, and Singapore. Its advocacy of a system of free trade and desire to attract foreign investment place Malaysia squarely in the West's camp. [REDACTED]

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Malaysia is not unaffected by geopolitical considerations; the Malaysian Government perceives the PRC to be the natural threat to the region, by virtue of its size, population, and geographic proximity. In addition, Malaysia has a large ethnic Chinese population--35 percent of total population--which has maintained ties with the Mainland. [REDACTED]

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[REDACTED]

[REDACTED] Although the Malaysian Government tacitly cooperates with China against the Vietnamese occupation of Cambodia, rapprochement is limited by at least two factors: the PRC continues to provide moral support to the outlawed Malaysian Communist Party and also persists in providing Malaysian Chinese with visas to visit the Mainland. [REDACTED]

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Despite these factors, the Ministry of Trade and Industry sent a delegation--in October 1984--to China with the objectives of expanding trade relations between the two countries and promoting the direct sale of Malaysian factory products and semiprocessed products on Chinese markets.

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[redacted]

The balance of trade between Malaysia and the PRC is heavily in China's favor. In 1983, exports to China were only \$432.9 million, compared to \$735.9 million in imports. In addition, the two countries are involved in negotiations to conclude bilateral trade and shipping agreements; China is seeking "most favored nation" treatment for its crew entering Malaysian ports. According to press reports, Malaysia presently only allows free entry of Chinese vessels into its ports, but not the crew--for security reasons. [redacted]

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Similarly, Malaysia's relations with the Soviet Union are somewhat contradictory. The GOM--and Prime Minister Mahathir in particular--are extremely cautious in their dealings with the Soviets. Their natural suspicion of the Communist state was compounded by the discovery in 1981 that one of Mahathir's own secretaries was a Soviet agent. The 1983 downing of Korean Air Lines flight #007 prompted the GOM to cancel the visit of a Soviet delegation. Later statements by Soviet Deputy Foreign Minister Mikhail Kapitsa, threatening support of insurgent movements in Southeast Asia if ASEAN countries would continue "confrontational policies" vis-a-vis Vietnam, did not improve matters. [redacted]

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The Soviet presence in Malaysia is limited and carefully monitored by the Malaysian Government. Soviet requests to increase their presence in Malaysia--for instance, by stationing a rubber expert in Kuala Lumpur to solve alleged problems in rubber quality--have been turned down or ignored by the Government. [redacted]

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[redacted]

There are currently 50 Soviets stationed in Malaysia. [redacted]

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[redacted]

In June of 1984, a USSR-Malaysian cultural exchange program was instituted: the Soviets sent a folk troupe, two TASS correspondents, and a photographic exhibition; the Malaysians were to send several post-graduates to the USSR for study, a weight-lifting coach for a short training course, and two Department of Information officials on a study tour. According to a January 1985 report from the Embassy in Kuala Lumpur, the sole active friendship society with a communist country is the Malaysian-Soviet Friendship Society (MSFS). Its activities are closely monitored and controlled by the Royal Malaysian Police, Special Branch which interviews attendees of MSFS functions. There were no Malaysian Exchange Students in any communist country in 1984. [redacted]

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[REDACTED]

The second half of 1984, however, witnessed several important developments in the Malaysian-Soviet relationship. The Soviets began to press the Malaysian Government to improve the trade relationship, which is strongly in Malaysia's favor. In 1983, Malaysia's exports to the Soviet Union equaled \$700.6 million; imports from the USSR were only about \$20 million. [REDACTED]

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Responding to Soviet blandishments over the negative trade balance, Mahathir sent a trade delegation to the Soviet Union in September, 1984, to initiate discussion on the possible sale of Soviet helicopters to the Malaysian Armed Forces and on the use of Soviet vessels to haul Malaysian products. This was followed up in November by a Malaysian Air Force delegation; [REDACTED]

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[REDACTED] According to the US Embassy, the Malaysian military is hesitant to purchase Soviet equipment because they don't want teams of Soviet technicians coming to Malaysia. [REDACTED]

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Malaysia also maintains relations with the Eastern European Bloc countries and Yugoslavia. In 1983, Malaysia initiated talks with Yugoslavia and Romania on the possibility of barter trade. Minister of Trade and Industry Rithauddeen also indicated that similar talks with Hungary and East Germany as well as the Soviet Union were possible. Prime Minister Mahathir in 1983 traveled to Yugoslavia and Romania; he was specifically interested in the transfer of technology in oil and petroleum industry by Romania. During a press conference after a meeting with the Czech Foreign Minister in Kuala Lumpur in April, 1983, Rithauddeen stated that Malaysia and Czechoslovakia agreed to exchange trade missions and to make an effort to improve bilateral trade relations. They also agreed to look into the possibility of setting up joint-ventures to facilitate the transfer of technology. Yugoslavia is also keen to participate in joint-venture projects to improve trade and economic relations with Malaysia. Presently, however, the actual level of trade with the East European countries is fairly low. [REDACTED]

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#### EVIDENCE OF TECHNOLOGY TRANSFER LOSSES

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We have little documented evidence to indicate that technology transfer losses are taking place to a significant degree in Malaysia. [REDACTED]

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According to press reports, the Ministry of Trade and Industry has identified an international syndicate which has stolen thousands of sophisticated components. They have taken measures to stop this illegal traffic, but this type of theft continues to plague the Malaysian microelectronics industry. Indeed, if anything, the problem appears to be growing. [REDACTED]

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Arms Sales and Diversions. The amount of arms sales and transfer from Malaysia is relatively insignificant. In 1981, Malaysia sold \$7 million worth of arms to Thailand. There is no other record of arms sales from Malaysia. There are no reported cases of arms transfer or diversion through Malaysia. [REDACTED]

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SUBJECT: The Potential for Technology Transfer Losses  
From and Through Malaysia [REDACTED]

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Distribution

Orig - Addressee

1 - Executive Director

1 - Executive Registry

1 - DDI

1 - ADDI

1 - DDI Registry

1 - DO/EA [REDACTED]

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1 - DDI/PES

1 - CPAS/Intelligence Liaison Staff

1 - NIC/AG

1 - CPAS/IMC

1 - P&PD (via CPAS/IMC)

2 - OCR/SSG/DB

1 - OSWR Chrono

1 - TTAC Chrono

1 - TTAC/TAG Chrono

1 - OSWR/PG/PS

1 - [REDACTED]

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OSWR/TTAC/TAG/[REDACTED] (14 Feb 85)

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